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10 December 2012

Chief Advisor
Law Design Practice Revenue Group
The Treasury
Langton Crescent
PARKES ACT 2600

BY EMAIL ONLY: partIVA@treasury.gov.au

Dear Sir/Madam

PROPOSED CHANGES TO THE GENERAL ANTI-AVOIDANCE RULE

Cleary Hoare Solicitors welcomes the invitation to provide comment and feedback in relation to the proposed amendment to Part IVA of the *Income Tax Assessment Act 1936*, released for public comment on 16 November 2012.

For over 20 years, Cleary Hoare Solicitors has specialised in providing specialist tax advice to accountants and their SME clients throughout Australia. Many of these clients own and operate their own businesses or investment structures established due to commercial considerations. As such, we consider our Firm uniquely placed to provide comments in relation to the exposure draft.

It is our view that the proposed changes are altogether too broad and are devoid of any commercial reality. The proposed amendments are significantly more wide-reaching than the original intentions of the regime. This change to the Part IVA regime should not be implemented in its current form. In making that submission, the following comments are relevant:

1. The Explanatory Memorandum to the *Income Tax Laws Amendment Bill (No. 2) 1981* said of the proposed anti-avoidance provisions:

   "The proposed new Part IVA, which this Bill will insert into the principal Act, is designed to overcome these difficulties and provide – with paramount force in the income tax law – an effective general measure against those tax-avoidance arrangements that – inexact though the words may be in legal terms – are blatant, artificial or contrived. In other words, the provisions are designed to apply where, on an objective view of the particular arrangement and its surrounding circumstances, it would be concluded that the arrangement was entered into for the sole or dominant purpose of obtaining a tax deduction or having an amount left out of assessable income."

2. In the Explanatory Memorandum, it is evident that the Government saw the "prediction test" in *Newton's Case* as its model for capturing the essence of what was to be caught by the anti-avoidance provisions. The provisions were to be inapplicable to schemes entered into in the course of ordinary business or family dealings and the criterion for determining whether something fell within the operation of the anti-avoidance rules was whether the identified scheme was blatant, contrived or artificial.

3. The 1983-84 Annual Report of the Australian Tax Office said:

   "At the time the boom in the promotion of tax-avoidance and evasion schemes of the kind experienced in the late '70s and early '80s was a thing of the past. That elimination of "paper schemes" is one of the success stories of the last decade. They have been beaten by a combination of legislation, administration, changes in attitude and sheer hard work."

   The blatant and contrived "Curran schemes", "trading stock schemes" and "bottom of the harbour schemes" that proliferated in the '70s and early '80s were effectively stopped by the general anti-avoidance regime. Part IVA as it was initially drafted has been successful.

4. The proposed changes seek to implement a "single, holistic enquiry into whether a person participated in the scheme with a sole or dominant purpose of securing for the taxpayer a particular tax benefit in connection with the scheme". The Explanatory Memorandum of the proposed changes illustrates that this is designed to bring focus away from the importance of alternative postulates in Subsection 177C.

5. The changes to 177C will require alternative postulates in which the taxpayer could reasonably be expected to achieve the same non-tax effects as achieved from the scheme. When hypothesising these alternative postulates to a scheme, no consideration is to be given to the potential tax costs of these alternatives.

6. These proposed changes demonstrate a complete disregard for the commercial reality of decision making that relates to the profitability of an enterprise and the employment of Australians in those enterprises. By seeking to close the door on the "do nothing" and the "unreasonable tax burden" alternatives, the legislation will be stepping away from the realities of commercial decision-making. Australian businesses routinely decide to not enter transactions on the basis that an excessive tax burden will make a transaction uncommercial. Preventing this reality from being examined when hypothesising alternative postulates would create an incongruency between regular business decision making and the general anti-avoidance rules.

7. In his speech introducing the proposed changes, the Assistant Treasurer, David Bradbury, highlighted that the reason for the Part IVA changes was to attempt to prevent large technology companies such as Amazon, Apple and Google from routing their profits through overseas entities and jurisdictions. Rather than developing a more robust transfer pricing regime, the legislature has decided to broaden Part IVA in such a way that will negatively effect commercial decision making for *all* ordinary Australian SME businesses.

8. In 1975, the Asprey Committee acknowledged that:

"In framing legislation sufficiently all-embracing to deter tax-avoidance, there is always the danger of penalising those who have genuine reason for entering into a bona fide transaction which, if carried out by others, has the objective that ought to be prevented. There is frequently such a very fine line to be drawn between the transaction which offends and the one which merits no condemnation."

9. By preventing consideration of potential tax costs to alternative postulates, the legislation is removing a tool for the judiciary to identify which transactions are tax-avoidant in nature, and which are bona fide transactions meriting no condemnation. We urge you to reconsider making these changes, as they will have negative consequences for ordinary Australian SMEs completing bona fide commercial transactions.

10. The balance in "getting it right" is not easy but the proposed amendments are nowhere near close to that balancing point. As the Honourable Murray Gleese AC said in the foreword of Justice Pagone's book "Tax Avoidance in Australia":

"The difficulties of legislating on the problem of tax avoidance can never be resolved to complete satisfaction. The difference between a 'blatant, contrived, and artificial' scheme and prudent fiscal planning may be easy to recognise at the extremes, but not at the margin. Yet the same applies to the difference between night and day. Furthermore, what is explicable by reference to ordinary business or family dealings changes over time. How many Australians nowadays receive a medical bill that is not issued in the name of a corporate entity? Fifty years ago, a doctor's bill that identified the creditor as a corporation would have borne the stamp of tax avoidance. Now it bears the stamp of wise superannuation planning. Parliament itself deliberately creates fiscal benefits to promote certain forms of business activity. The Act contains provisions designed to encourage taxpayers to act in a particular way; responding to such encouragement, if that is all there is to it, is normal business planning."

Thank you for the opportunity to provide these comments and we are happy to be involved in any further consultation. If you require any further clarification on the issues raised and our views on them, please do not hesitate to contact the writer.

Yours faithfully

Brett Hart
Cleary Hoare Solicitors